



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	05/06/03	Bill No:	SB 1016
Tax:	Cigarette and Tobacco Products	Author:	Bowen
Board Position:		Related Bills:	

BILL SUMMARY

This bill would require that every retail sale of cigarettes in California be a vendor-assisted, face-to-face sale, unless:

- The seller has fully complied with all of the requirements of the Jenkins Act, and
- The seller has either paid all applicable taxes due on the sale, or the seller includes a prominent notice on the package indicating that the purchaser is responsible for any applicable California taxes on the cigarettes.

This bill would also require the Board to provide information received pursuant to the Jenkins Act to the Attorney General.

Summary of Amendments

The amendments to this bill since the previous analysis: 1) delete the requirement that a seller provide quarterly reports of the information required pursuant to the Jenkins Act to the Board; 2) add a requirement that the Board provide information received pursuant to the Jenkins Act to the Attorney General; and 3) add a requirement that the Attorney General provide an annual report to the Legislature regarding all actions taken to comply with, and enforce, the Jenkins Act.

ANALYSIS

Current Law

Under current law, Section 30101 of the Cigarette and Tobacco Products Tax Law imposes an excise tax of 6 mills (or 12 cents per package of 20) on each cigarette distributed. In addition, Section 30123 and 30131.2 impose a surtax of 12 ½ mills (25 cents per package of 20) and 25 mills (50 cents per package of 20), respectively, on each cigarette distributed. The current total tax on cigarettes is 43 ½ mills per cigarette (87 cents per package of 20).

Sections 30123 and 30131.2 also impose a surcharge on tobacco products at a rate to be annually determined by the Board. The tobacco products tax rate is equivalent to the combined rate of tax on cigarettes. The surcharge rate for fiscal year 2002-03 is 48.89 percent.

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Section 30101.7 provides, in part, that no person may engage in a retail sale of cigarettes in California unless the sale is a vendor-assisted, face-to-face sale.

A “face-to-face sale” is defined to mean a sale in which the purchaser is in the physical presence of the seller or the seller’s employee or agent at the time of the sale. A face-to-face sale does not include any transaction conducted by mail order, the Internet, telephone, or any other anonymous transaction method in which the buyer is not in the seller’s physical presence. However, this does not prohibit any lawful sale of a tobacco product that occurs by means of a vending machine.

Persons may engage in a non-face-to-face sale of cigarettes to a person in California provided that the seller complies with either of the following conditions:

- All applicable California taxes on the cigarettes have been paid.
- The seller includes on the outside of the shipping container for any cigarettes shipped to a resident in California from any source in the United States, an externally visible and easily legible notice located on the same side of the shipping container as the address to which the package is delivered stating the following:

"IF THESE CIGARETTES HAVE BEEN SHIPPED TO YOU FROM A SELLER LOCATED OUTSIDE OF THE STATE IN WHICH YOU RESIDE, THE SELLER HAS REPORTED PURSUANT TO FEDERAL LAW THE SALE OF THESE CIGARETTES TO YOUR STATE TAX COLLECTION AGENCY, INCLUDING YOUR NAME AND ADDRESS. YOU ARE LEGALLY RESPONSIBLE FOR ALL APPLICABLE UNPAID STATE TAXES ON THESE CIGARETTES."

Current law also imposes a sales or use tax on the sale or purchase of tangible personal property in this state (including cigarettes and tobacco products). When a person sells cigarettes or tobacco products at retail in this state, the sales tax applies. The seller is responsible for this tax and must pay it to the state. When the sales tax does not apply, the use tax does. For example, when a person buys cigarettes from a point outside this state for the use or consumption in this state, the use tax is the applicable tax. If the out-of-state seller has nexus within the state, the seller is required to collect the use tax from the purchaser at the time of sale. If the seller does not collect the use tax, or if the seller does not have nexus in this state, the purchaser is required to pay the use tax directly to the Board.

Federal Jenkins Act. Chapter 10A of Title 15 of the United States Code (also known as the Jenkins Act) requires any person that sells or transfers cigarettes for profit in interstate commerce and ships the cigarettes into a state that imposes a tax on cigarettes to file by the 10th of each calendar month a memorandum or a copy of the invoice for each and every shipment of cigarettes made during the previous calendar month in that state. This information is required to show the name and address of the person to whom the shipment was made, the brand, and quantity of the shipment. Any person who violates these provisions shall be guilty of a misdemeanor and shall be subject to a fine of not more than \$1,000, imprisoned not more than 6 months, or both.

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Proposed Law

This bill would amend Section 30101.7 of the Revenue and Taxation Code to provide that a person may engage in a non-face-to-face sale of cigarettes to a person in California provided that both of the following conditions are met:

- The seller has fully complied with all of the requirements of Chapter 10A (commencing with Section 375) of Title 15 of the United States Code, otherwise known as the Jenkins Act.
- The seller has fully complied with either of the following requirements:
 - (1) All applicable California taxes on the cigarettes have been paid.
 - (2) The seller includes on the outside of the shipping container for any cigarettes shipped to a resident in California from any source in the United States an externally visible and easily legible notice located on the same side of the shipping container as the address to which the package is delivered stating as follows:

"IF THESE CIGARETTES HAVE BEEN SHIPPED TO YOU FROM A SELLER LOCATED OUTSIDE OF THE STATE IN WHICH YOU RESIDE, THE SELLER HAS REPORTED PURSUANT TO FEDERAL LAW THE SALE OF THESE CIGARETTES TO YOUR STATE TAX COLLECTION AGENCY, INCLUDING YOUR NAME AND ADDRESS. YOU ARE LEGALLY RESPONSIBLE FOR ALL APPLICABLE UNPAID STATE TAXES ON THESE CIGARETTES."

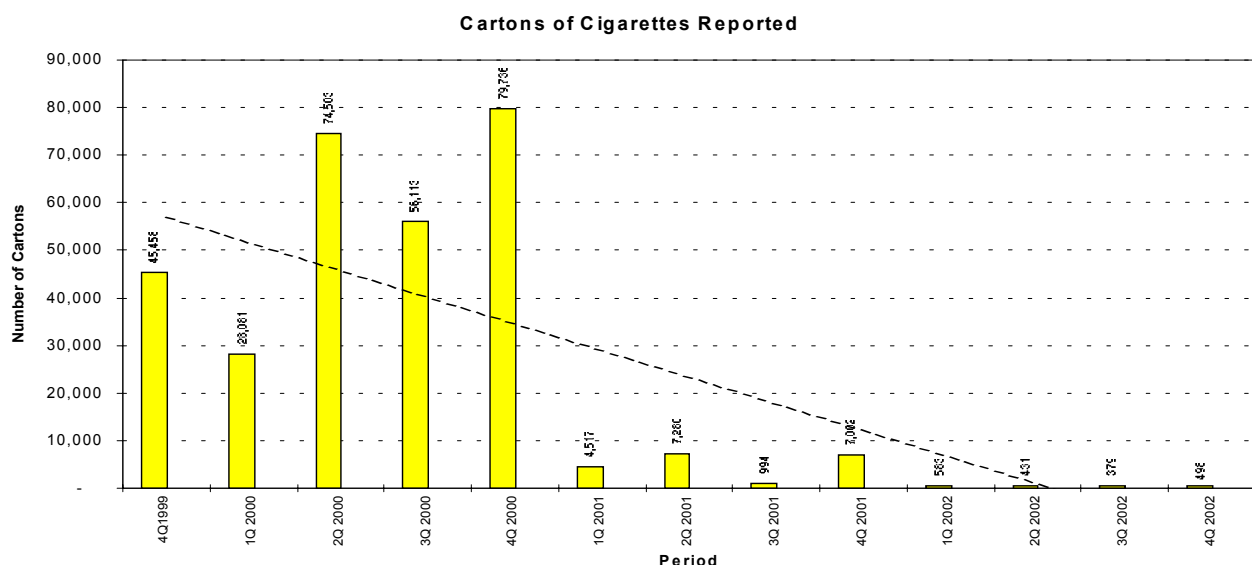
This bill would also require the Board to provide information received pursuant to the Jenkins Act to the Attorney General. The Attorney General would be required to provide an annual report to the Legislature regarding all actions taken to comply with, and enforce, the Jenkins Act.

The bill would become operative January 1, 2004.

In General

Because of the state excise tax imposed on cigarettes and the sales tax due on such sales, many consumers have turned to the Internet as a way of obtaining cigarettes from out-of-state sellers who do not charge the California taxes. In May 1999, the Board began a program to promote Jenkins Act compliance by out-of-state cigarette distributors. Since the inception of the program, 387,039 cartons of cigarettes have been reported to the Board, which represents \$3,367,239 (387,039 cartons x \$8.70 excise tax per carton = \$3,367,239) in cigarette excise tax. The following graph summarizes by quarter the number of cartons of cigarettes reported to the Board from October 1, 1999 to December 31, 2002.

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As shown in the chart, the number of cartons of cigarettes reported pursuant to the Jenkins Act has significantly decreased since the compliance program commenced.

With respect to the number of cartons of cigarettes that are not being reported, the Board recently estimated cigarette excise tax revenues for out-of-state cigarette purchases to be \$53.9 million per year. However, that figure includes out-of-state purchases from all untaxed out-of-state sources, including the Internet, mail order, and cross border sales. The Jenkins Act only applies to Internet and mail order sales, which staff estimates to be 40 percent of the total amount of out-of-state sales. Therefore, it is estimated that approximately \$21,560,000 ($\$53,900,000 \times .40 = \$21,560,000$) in excise tax or 2,478,161 ($\$21,560,000 / \$8.70 \text{ excise tax per carton} = 2,478,161$) cartons of cigarettes, is not being reported to the Board on an annual basis*.

Background

Senate Bill 1766 (Ch. 686, Stats. 2002, Ortiz) added Section 30101.7 to the Cigarette and Tobacco Products Tax Law to require, in part, that every retail sale of cigarettes in California be a vendor-assisted, face-to-face sale, unless all applicable taxes due on the sale are paid or the seller includes a prominent notice on the package indicating that the purchaser is responsible for any applicable California taxes on the cigarettes.

On April 1, 2003, Attorney General Bill Lockyer filed lawsuits to enforce, in part, the provisions of SB 1766. Specifically, the lawsuits were filed against five out-of-state tobacco retailers for selling cigarettes to minors via the Internet, failing to report tobacco sales to California tax authorities, and depriving the state of excise taxes. The complaints allege that the defendants have violated California laws that govern payment of excise taxes on Internet cigarette sales, and federal statutes that require out-of-state sellers to report such sales to California tax agencies. Additionally, the lawsuits allege the defendants have wrongfully denied the state revenue. The defendants' failure to

* This number was not adjusted for cartons of cigarettes reported to the Board since that volume is deemed to be relatively insignificant to the estimated \$53.9 million per year in out-of-state purchases of cigarettes.

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notify consumers of their obligation to pay taxes constitutes deceptive advertising, according to the complaints.

In 2002, Senate Bill 2082 (Bowen) would have required any person who advertises on the Internet to sell cigarettes in California, and who is subject to the provisions of the Jenkins Act, to conspicuously disclose that a purchaser who buys cigarettes shipped into California is responsible for paying the state excise tax and the state use tax and to show in the advertisement the amount of these taxes that would be due. This bill would have also required the person selling or transferring the cigarettes to provide to the Board a copy of the invoice for each shipment made into California. That bill failed passage out of the Assembly Revenue and Taxation Committee.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author to facilitate the collection of taxes on cigarettes sold to residents of California over the Internet or by mail order.
2. **Key amendments.** The **May 6, 2003**, amendments delete one of the three requirements for a person to engage in a non-face-to-face sale of cigarettes to a person in California. Specifically, that requirement provided that the seller provide quarterly reports of the information provided to the state pursuant to the Jenkins Act to the Board. The amendments also require the Board to provide information received pursuant to the Jenkins Act to the Attorney General, and require the Attorney General to provide an annual report to the Legislature regarding all actions taken to comply with, and enforce, the Jenkins Act.

The **April 22, 2003**, amendments delete the previous provisions in the bill, which would have prohibited a public or private postal or package delivery service from knowingly delivering a package containing a tobacco product in this state, unless the seller had paid all applicable California taxes on the cigarettes, or included a prominent notice on the package indicating that the purchaser is responsible for any applicable California taxes on the cigarettes.

3. **Internet purchases.** As efforts increase in this state to stop the illegal sale of cigarettes to minors, minors may find it more difficult to purchase cigarettes from traditional locations such as liquor stores and gas station mini-marts. This may lead to minors turning to the Internet as a means of acquiring cigarettes since the retailer is not likely to verify the age of the purchaser. This can lead to additional tax avoidance since the Internet retailer is unlikely to collect the California taxes due and the minor purchasing cigarettes is unlikely to self-report the California taxes due.
4. **The Jenkins Act.** The Jenkins Act requires any person that sells or transfers cigarettes for profit in interstate commerce and ships the cigarettes into a state that imposes a tax on cigarettes to file by the 10th of each calendar month a copy of the invoice for each and every shipment of cigarettes made during the previous calendar month in that state. Many consumers who shop on the Internet may not be aware of these provisions and think they are successfully avoiding the tax by purchasing cigarettes from out-of-state sellers over the Internet. The Board utilizes the information required to be provided by the Jenkins Act to bill consumers for the taxes

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due. Unfortunately, some cigarette retailers do not comply with the provisions of the Jenkins Act. Since the Jenkins Act is a federal statute, the Board requires the assistance of federal law enforcement agencies to enforce the provisions of the Jenkins Act. Also, the provisions of the Jenkins Act apply only to the sale of cigarettes, not tobacco products.

5. **Enforcement.** This bill would make additional requirements of any person who sells cigarettes to consumers in this state. However, some of these retailers are located outside California and have no business presence in this state. Without a presence in this state, the state would have a difficult time enforcing the provisions of this bill.

COST ESTIMATE

Any costs associated with the provisions of this bill are expected to be absorbable.

REVENUE ESTIMATE

The provisions of this bill may have a positive impact on the state excise tax collected on sales of cigarettes and also on use tax collected on cigarettes and tobacco products purchased from out-of-state retailers. However, the Board has no way of measuring the potential impact these provisions may have, and therefore, cannot provide an estimate at this time.

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